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270318Z Jan 05

UNCLAS SECTION 01 OF 02 HO CHI MINH CITY 000104

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SENSITIVE

DEPARTMENT PLEASE PASS USTR, ELENA BRYAN
USDOC FOR 6500 AND 4431/MAC/AP/OPB/VLC/HPPHO

E.O. 12958: N/A

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SUBJECT: STATE TRADING IN VIETNAM - PETROVIETNAM A
PROBLEM FOR U.S. OIL AND GAS

1. (U) This is the first in a series of cables on industry perspectives in southern Vietnam on the role of the state in the economy.

SUMMARY

2. (SBU): Vietnam's oil and gas industry is completely controlled by the state-owned Vietnam Oil and Gas Corporation, known as PetroVietnam. U.S. companies in Ho Chi Minh City are critical of the company that is simultaneously a partner, manager, service provider and regulator. They are unanimous in the view that PetroVietnam is poorly managed, lacks transparency and often displays ignorance of basic business principles. These weaknesses constrain U.S. companies' ability to do business in the oil and gas sector and hinder Vietnam's capacity to fully exploit its oil and gas resources. END SUMMARY.

MANAGEMENT WITH SKEWED PRIORITIES

3. (SBU) In a series of meetings with senior U.S. energy company leaders (protect,) Econoff heard that that PetroVietnam officials are primarily concerned with control and make poor management decisions as a result. A case in point is the state-owned enterprise's recent decision to reduce the oil production of one venture. ConocoPhillips has a 25 percent stake in a consortium that is approved to produce 65,000 barrels per day. However, the field has developed better than expected, and the consortium has been producing oil 88,000 bpd. In December, Conoco received a written order from PetroVietnam requiring that production be immediately reduced from 88,000 to 65,000 bpd. PetroVietnam's stated rationale was that Conoco was removing resources too quickly and irresponsibly. Conoco maintains it is producing in accordance with international standards, and says that privately PetroVietnam's technical employees are satisfied with Conoco's methods and do not understand their superiors' rationale.

4. (SBU) Conoco has already contracted for future sales based on the 88,000 bpd rate. If production is cut immediately, Conoco would pay hefty penalties. After Conoco told PetroVietnam that the state company would be responsible for these penalties, PetroVietnam ordered Conoco to produce 88,000 bpd until future sales commitments were fulfilled before eventually dropping production to 65,000 bpd.

5. (SBU) Conoco speculates that PetroVietnam is "saving" resources to produce at 100 percent ownership in the future, when the foreign investor contracts expire. Conoco has a 20-year operating license for this block, so the loss of revenue if the production cap is maintained will be considerable. PetroVietnam has a 50 percent stake in the consortium and stands to lose revenues by capping production. Further, the GVN loses tax revenues. The tax rate for this field is the highest of those in operation - at the height of production, the GVN benefits from an 80 percent tax rate.

LACK OF ECONOMIC SENSE AND PROFESSIONAL EXPERTISE

6. (SBU) U.S. companies cite numerous examples to illustrate PetroVietnam's ignorance of international standards and economics. Unocal reports that it has been negotiating with PetroVietnam for more than two years on a development agreement and expects to sign a contract by the end of January. Ironically, the final contract is virtually identical to the original proposal. From Unocal's perspective, PetroVietnam was incapable of evaluating its offers or of understanding standard industry practices or terms in comparable

contracts.

17. (SBU) Unocal offered to model its development contract on a similar agreement between British Petroleum (BP) and PetroVietnam. (Note: BP's negotiations took 10 years to finalize. End Note.) Unocal's discovery was two large, but separate, gas deposits within two exploration blocks and the company proposed developing both deposits as a unified area to lower capital costs and maximize efficiency. PetroVietnam viewed this as a divergence from the original contract and insisted on each deposit being developed separately. Unocal attempted to explain that PetroVietnam would lose millions following this route. According to Unocal, one PetroVietnam engineer said, "We don't care about economics! We want to put the platform where there is the most gas." Unocal eventually spent \$30,000 to hire a third-party industry consultant to explain gas development methods and analyze Unocal's proposal for PetroVietnam. Unocal reports PetroVietnam was receptive to the consultant, but the company was frustrated at having to educate PetroVietnam's employees about both the science and economics of the industry.

18. (SBU) ConocoPhillips reports that it has also been overruled on production decisions by PetroVietnam without any technical or financial reasoning. For example, to maintain well pressure in its field, Conoco proposed injecting 20,000 barrels of water/day into five wells at a cost of \$75 million. PetroVietnam forced Conoco to drill eight or nine water injection wells at a cost of \$200 million, without any technical explanation.

SUBSIDIARIES HELP PETROVIETNAM RETAIN CONTROL

19. (SBU) U.S. companies report that PetroVietnam uses an interlocking network of subsidiaries to maintain its complete control of the oil and gas sector. In the past, PetroVietnam has created subsidiary companies to compete with Halliburton, which provides services to the industry. PetroVietnam has announced plans to divest three subsidiaries by the end of 2005: the Petroleum Technical Services Company, the Drilling and Well Services Company, and the Drilling Mud Company. However, the state will retain a more than 50 percent stake in the companies, limiting foreign ownership to 30 percent. ConocoPhillips and Unocal both report that PetroVietnam frequently prohibits foreign companies from bidding on projects that are then awarded to subsidiaries and frequently requires foreign companies to use PetroVietnam subsidiaries as suppliers. According to Halliburton, these subsidiaries are often poorly organized and managed, and their employees lack the appropriate skills and knowledge. All the companies agreed PetroVietnam is run like an opaque government ministry rather than a business enterprise.

COMMENT

10. (SBU) As U.S. companies point out, PetroVietnam is in an enviable position. It is able to capture rents and revenues at every step in the process - royalties, taxes, service fees, etc. And as oil and gas are Vietnam's top exports, bringing in \$5.6 billion in 2004, PetroVietnam is the GVN's largest revenue generator. However, lack of industry experience, professional expertise, and business understanding by PetroVietnam is preventing both U.S. investors and the GVN from reaping maximum benefits. If PetroVietnam continues to forego profit and experience in the interest of complete industry control, foreign participation in the oil and gas sector will become even more difficult.

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